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IN THE

Supreme Court of the United States

October Term, 1971.

Nos. 71-1141, 71-1229.

THE STATE OF NEW YORK,

Petitioner,

v.

PENN CENTRAL TRANSPORTATION COMPANY,

Respondent—Debtor in Reorganization.

THE STATE OF NEW JERSEY,

Petitioner,

v.

PENN CENTRAL TRANSPORTATION COMPANY,

Respondent—Debtor in Reorganization.

BRIEF FOR RESPONDENT IN OPPOSITION.

EDWIN P. ROME,
RICHARD P. MCELROY,
BLANK, ROME, KLAUS & COMISKY,
11th Floor, Four Penn Center,
Philadelphia, Pa. 19103
Special Counsel for the Trustees of the Property of the Penn Central Transportation Company.

ROBERT W. BLANCHETTE,
Counsel for the Trustees of the Property of the Penn Central Transportation Company.

International, 711 So. 50th St., Phila., Pa. 19143—Tel. SA 7-8711 Area Code 215

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QUESTIONS PRESENTED.

1. Whether a district court presiding over the reorganization of a railroad has the power to authorize the Trustees of the property of the Debtor in reorganization to defer temporarily the payment of property taxes which accrued during reorganization?

2. Whether the district court properly exercised its discretion in directing deferral of the payment of taxes so as to assure continued operation of rail services by the Debtor?

STATUTES INVOLVED.

Bankruptcy Act § 77(j) (U. S. C. Title 11 § 205[j]):

> "In addition to the provisions of section 11 of this title for the staying of pending suits against the debtor, the judge may enjoin or stay the commencement or continuation of suits against the debtor until after final decree; and may, upon notice and for cause shown, enjoin or stay the commencement or continuance of any judicial proceeding to enforce any lien upon the estate until after final decree. . . ."

Title 28 U. S. C. § 960:

> "Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation."

STATEMENT OF THE CASE.

On June 21, 1970, the petition of the Penn Central Transportation Company (the Debtor) for reorganization under Section 77 of the Bankruptcy Act, 11 U. S. C. § 205, was approved by the Reorganization Court. Soon after their appointment, the Trustees of the Debtor concluded that anticipated revenues from operations and other funds would not be sufficient or available to meet all the Debtor's current operating obligations. Faced with the necessity to maintain rail operations despite this financial crisis, the Trustees on August 28, 1970 filed a petition to defer the payment of taxes which became due and payable after June 21, 1970.

The estate of the Debtor is subject to taxes payable to approximately 2,600 tax collecting agencies in 34 states and the District of Columbia. The unpaid taxes for 1970 amounted to over $34,000,000, and approximately $64,000,000 will be payable each year thereafter. Based upon cash-flow projections, affidavits and other exhibits presented to the Reorganization Court at the time of the hearing on the Trustee's petition, the Court found that it would be "impossible for the debtor to pay any substantial part of its tax liabilities by December 31, 1970", and further that the Debtor would be "barely able to meet current operating expenses during that period." These facts were not disputed in the proceedings below.

On October 26, 1970, the Reorganization Court entered Order No. 70, which, *inter alia*, directed the Trustees to make no further payment of taxes until further order of the Court and enjoined the taking of any action of seizure, foreclosure or tax sale by governmental entities.

Notwithstanding the temporary relief afforded by Order No. 70, the financial condition of the Debtor's estate remained precarious. At the end of December 1970, the

cash balance of the estate had diminished to $29,415,318;[1] had accrued taxes then been paid, the railroad would have had to cease operations. Only last-minute relief by the Congress, in the form of the Emergency Rail Services Act of 1970 (45 U. S. C. §§ 661 et seq.), has permitted essential rail operations to continue thus far.

Of the numerous taxing entities which were notified of and appeared for the hearing in the Reorganization Court only the States of New Jersey and New York appealed from the entry of Order No. 70. The United States Court of Appeals for the Third Circuit affirmed the Order, concluding that Section 77 of the Bankruptcy Act did authorize the Reorganization Court to enjoin temporarily the payment or collection of the assessed property taxes, and that under the circumstances the Reorganization Court properly exercised its authority.

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1. Document No. 1062—Statement of Assets and Liabilities of Debtor as of December 31, 1970.

REASONS FOR DENYING THE WRIT.

I. The Case Was Correctly Decided by the Court Below.

A. To Effectuate Its Jurisdiction, the Reorganization Court Has the Power to Authorize Trustees to Defer the Payment of Property Taxes.

Section 77 of the Bankruptcy Act, 11 U. S. C. § 205, grants to a Reorganization Court exclusive jurisdiction over a debtor and its property wherever located. It has been consistently held by this Court that this grant of jurisdiction gives the Reorganization Court the:

> "power to preserve the railway as a unit and as a going concern and to prevent it from being divided up and dismembered piece-meal." *Gardner v. State of New Jersey*, 329 U. S. 565, 577 (1947).

See also *Continental Illinois National Bank & Trust Co. v. Chicago, R. I. & P. Ry Co.*, 294 U. S. 648 (1935) and *Lowden v. Northwestern National Bank & Trust Co.*, 298 U. S. 160 (1936).

The Reorganization Court's power, which is implicit in its capacity as a court of equity presiding over a reorganization, has been made explicit by Congress in Section 77(j) of the Bankruptcy Act. That Section provides, in part:

> "In addition to the provisions of section 11 of this title . . . the judge . . . may, upon notice and for cause shown, enjoin or stay the commencement or continuance of any judicial proceeding to enforce *any lien* upon the estate until after final decree. . . ." (Emphasis added.)

Gardner held that Section 77(j) applies to tax liens of a state. Since the Reorganization Court has the power to

prevent the enforcement of a tax lien, it undoubtedly has power to prevent the payment or collection of taxes when the result would inevitably lead to the immediate failure of reorganization and a cessation of rail operations.

It was undisputed in the proceedings below, and was expressly found by the Reorganization Court, that the Debtor was unable to meet its tax obligations in any substantial part and was barely able to meet current operating expenses. Under such circumstances, the Reorganization Court certainly has the power to authorize its Trustees to defer tax payments so that the goal of Section 77 can be achieved, namely continued rail operations in the public interest during the reorganization process. *Continental Illinois National Bank & Trust Co. v. Chicago, R. I. & P. Ry. Co., supra.; Susquehanna Chemical Corp. v. Producers Bank & Trust Co.*, 174 F. 2d 783 (3d Cir. 1949); and *In the Matter of the New York, New Haven and Hartford Railroad Co.*, (D. Conn. No. 30226, Order No. 54 dated January 5, 1962; Memorandum of decision in support of Order No. 25, filed October 20, 1961).

B. Order No. 70 Was a Proper Exercise of Discretion by the Reorganization Court.

The trustees of a railroad in reorganization have the duty to operate the business in the public interest, Section 77(c)(2), 11 U. S. C. §205(c)(2), and "to that end such expenditures must be made as are reasonably necessary to preserve and protect those interests and maintain the integrity of the railroad, so that it may be turned over to the reorganized company as a going concern." *Van Schaik v. McCarthy*, 116 F. 2d 987, 993 (10th Cir. 1941). When revenues and other available funds are not adequate to meet all necessary expenses (of which taxes are admittedly one), the Trustees and ultimately the Court must,

decide, in the exercise of sound discretion, which expenditures are most necessary to achieve the ends reorganization seeks and to preserve the estate, with a minimum of hardship to third persons. In weighing the competing interests, the statement in *Southern Railway Co. v. United States*, 306 F. 2d 119, 127 (5th Cir. 1962), offers some guidance:

> "Operational expenses they [taxes] surely are, but they are scarcely more operational than other traditional charges, such as repair and maintenance of railway equipment, rental and apportionment of operating charges. . . . We know that the Governments of each of the cities and counties, that of the States of Georgia and North Carolina and of the United States did, and would have continued to, exist regardless of the fate of the [debtor]. So it is actually more realistic to say that without the continued operations by the receivership, there would have been no payrolls to generate the taxes. . . ."

On balance, the Order of the Reorganization Court represents the most fair and equitable solution to a difficult problem. In its opinion, the Reorganization Court specified the factors relevant to its ruling and evidenced a significant degree of sensitivity to the problem facing it. While protecting the public interest in the continuation of rail operations, the court below was undoubtedly mindful of possible hardships caused by the implementation of a broad and sweeping order. Instead, Judge Fullam provided for only temporary deferment and even that was dependent upon an absence of a showing of undue hardship by any taxing entity. Under these circumstances, and when the continued operation of the railroad was vitally at stake, it can hardly be said that there was an abuse of discretion.

A word here should be added with respect to the statement by respondent, the State of New Jersey, on page 9

of its Petition imputing an intention on the part of the Trustees to continue the deferral of taxes. Suffice it to say that in the Trustees' Plan for Reorganization (p. 15) filed with the Reorganization Court on April 1, 1972, the Trustees reported the likelihood of resumption of tax payments by October 1, 1972 and, further, that a petition for modification of Order No. 70 will be filed.

II. The Decisions Below Are in Conformity With the Decisions of This Court and the Courts of Appeals.

The respondent does not dispute that the Trustees are liable for current property taxes; nor does it challenge the relative priority which is to be accorded administrative expenses, of which taxes accruing during reorganization are admittedly a part. The sole question is whether a Reorganization Court is able to delay the payment of property taxes when funds and current income from operations are insufficient to meet tax obligations as they accrue.

The three decisions of this Court cited by petitioners do not meet this question. *Michigan v. Michigan Trust Co.*, 286 U. S. 334 (1932), held simply that a receiver of a corporation is subject to franchise taxes on the corporation's privilege to do business in a state, and, consequently, franchise taxes which accrue during the receivership are expenses of administration to be accorded priority over general and secured creditors. That case involved a "friendly receivership" designed to forestall the normal process of bankruptcy and, in the words of Justice Cardozo, is "to be watched with jealous eyes lest [its] function be perverted" (286 U. S. at 345). Obviously, no such consideration is involved in this reorganization. On the contrary, Section 77 reflects the public interest in continuing operations of the railroad during reorganization and in forestalling the normal process of bankruptcy. Moreover, the Court in *Michigan Trust Co.* was not faced with the fact that funds

were not available for the payment of taxes as they accrued, and hence, expressed no opinion as to the obligations of the receiver in those circumstances.

The remaining two cases cited by petitioners (*Palmer v. Webster Atlas National Bank of Boston*, 312 U. S. 156 (1941); and *Lyford v. State of New York*, 140 F. 2d 840 (2d Cir. 1944), cert. denied 323 U. S. 714) actually support the decisions of the courts below. In *Palmer* this Court held that the trustees of the New Haven Railroad were not liable for the payment of current taxes of two of its lessor railroads, which were themselves in reorganization. This Court stated (312 U. S. at 165):

> "*If* the trustees of either of the lessor's properties were able to operate the lines and *from the proceeds of that operation, or from any other source, were in possession of available funds*, it would be the duty of the court in view of the Act of 1934 [now 28 U. S. C. § 960] to require them to pay the taxes applicable to the business they are conducting under the orders of the court." (Emphasis added.)

In *Lyford* the Court of Appeals (not this Court as stated by petitioners) held that a plan of reorganization must make provision for the payment of taxes which accrued during reorganization. Implicit in the case is the fact that trustees are not required to pay taxes as they accrue when there are insufficient funds to pay them. In accord with these decisions are *Boteler v. Ingels*, 308 U. S. 57 (1939); *Southern Railway Co. v. United States, supra;* and *In re Pressed Steel Car Co. of New Jersey*, 100 F. 2d 147 (3d Cir. 1938).

The position of petitioners under the circumstances of this case, if sustained, would require the Trustees to pay property taxes as they accrue regardless of their ability to

do so, and would abrogate the Trustees' duty to continue vital rail services. That result is contrary to the purpose and scheme of Section 77 as interpreted by this Court in *Gardner v. State of New Jersey, supra; Lowden v. Northwestern Nat'l Bank & Trust Co., supra;* and *Continental Illinois Nat'l Bank & Trust Co. v. Chicago, R. I. & P. Ry. Co., supra.*

CONCLUSION.

For the foregoing reasons, the Petition for a writ of certiorari should be denied.

Respectfully submitted,

EDWIN P. ROME,
RICHARD P. MCELROY,
BLANK, ROME, KLAUS & COMISKY,
Special Counsel for the Trustees.

ROBERT W. BLANCHETTE,
Counsel for the Trustees.